Brief summary of Economic MEIP/PSO assessment of the Amendment to the Heads of Terms

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September 24th 2013

1 Introduction

1.1 Oxera is a leading economics consultancy with a specialist practice in state aid, and has offices in the UK, Belgium and Germany.

1.2 On August 1st 2013 the Dutch State ('the State') asked Oxera to carry out an economic and financial analysis for the MEIP (Market Economy Investor Principle) test and the PSO (Public Service Obligation) test. These tests concern an Amendment to the Heads of Terms for the integrated rail concession. Oxera's analysis is provided as an input to a legal assessment of state aid risk.

1.3 This analysis follows an earlier state aid assessment that Oxera made in 2011/2 of the previous agreement regarding the integrated concession.

2 MEIP test

2.1 Oxera's conclusions regarding the Venus Amendment from an MEIP perspective are as follows. In general, there are two ways to test the MEIP:

– profitability analysis: is the expected return for a given measure in line with the benchmark cost of capital?

– comparator analysis: is the price being paid in line with the market price?

2.2 Therefore for profitability analysis Oxera focuses on the question: is the expected return for a given measure in line with the benchmark cost of capital? If the expected return for NS is not

higher than the benchmark, this indicates that the Amendment is likely to be market-conforming.

2.3 It is noted that the incentive and risk balance in the Amendment is highly specific, and accordingly it is difficult to compare this against market benchmarks. Owing to this uncertainty, and acknowledging the presence of downside protection provided to NS under the amended Heads of Terms, Oxera places weight on the lower part of the benchmark range. The NS expected returns are in line with the midpoint of the lower part of the benchmark range, and therefore not excessive.

2.4 There are indications that NS is among the most efficient railway undertakings in the EU. Accordingly, Oxera concludes that, from a profitability perspective, the expected return is prudently in line with the appropriate cost of capital and therefore MEIP-compatible. This assumes that the Venus business case is robust, and that the First Dutch analysis of potential payments from the Ministry of I&E to NS is also robust.

2.5 For comparator analysis Oxera focuses on the question: is the price being paid in line with the market price? In this regard the first point to note is that the Ministry appears satisfied that Venus gives a good solution from the consumer perspective, offering an acceptable service on the HRN and HSL.

2.6 The Ministry of I&E has carried out evaluation of alternatives in a short timetable without market-testing them (eg, asking for formal proposals from alternative suppliers). However, according to the evidence seen by Oxera, the Ministry's decision to accept the Amendment would be compatible with the risk-adjusted choice of a market economy investor.

2.7 The Ministry has considered both the expected financial return of alternatives, and the riskiness of those returns. This is a similar exercise to attempting to observe 'the market price'. The Ministry of I&E, with its advisors, has found Venus to be market-conforming on a risk-weighted basis.

2.8 Oxera therefore concludes that, from a comparator perspective, the decision of the Ministry is MEIP-compatible. This assumes that the analysis of alternatives by the Ministry and its advisors is robust.

MEIP conclusion

2.9 Oxera considers that the overall risk of failing the economic and financial tests of the MEIP is relatively low, subject to the legal instructions given to Oxera.

2.10 Oxera has separately assessed the agreement between NS and Eurostar,[1] and has concluded that this arrangement does not change the MEIP conclusion.

3 PSO test

3.1 Oxera's finding is that the expected return according to the Venus proposal is in line with the relevant benchmarks. The financial analysis underpinning this conclusion is the same as

[1] Oxera (2013), 'Economic MEIP assessment. Cooperation Agreement: London–Amsterdam Direct Services between EIL and NS Groep', Final report for EIL and Dutch State (non-confidential version), September 20th, p. ii.

described above for the MEIP. This indicates compliance with Regulation 1370, which is the relevant legal framework for the PSO test.

3.2 Oxera therefore considers that the overall risk of failing the economic and financial tests of Regulation 1370 is also low, subject to the legal instructions given to Oxera.